COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE JOINT PETITION OF KENTUCKY-AMERICAN WATER COMPANY, THAMES WATER AQUA HOLDINGS GMBH, RWE AKTIENGELLSCHAFT, THAMES WATER AQUA US HOLDINGS, INC., AND AMERICAN WATER WORKS COMPANY, INC. FOR APPROVAL OF A CHANGE IN CONTROL OF KENTUCKY-AMERICAN WATER COMPANY	))))))))	**CASE NO. 2006-00197**

JOINT PETITIONERS' MEMORANDUM IN RESPONSE TO THE MEMORANDA OF THE ATTORNEY GENERAL AND THE LEXINGTON-FAYETTE URBAN COUNTY GOVERNMENT AND TO THE PUBLIC COMMENT OF BLUEGRASS FLOW, INC.

Come RWE Aktiengesellschaft ("RWE"); Thames Water Aqua Holdings GmbH ("Thames GmbH"); Thames Water Aqua US Holdings, Inc. ("TWAUSHI"); American Water Works Company, Inc. ("American Water"); and Kentucky American Water Company ("KAWC") (collectively, "Joint Petitioners"), and file their Memorandum in Response to the Memoranda of the Attorney General and the Lexington-Fayette Urban County Government ("LFUCG") and to the "Public Comment" filed by Bluegrass FLOW, Inc. ("FLOW").[1]

INTRODUCTION

On June 5, 2006, Joint Petitioners filed their Petition ("Petition") pursuant to KRS 278.020, and all other applicable statutory and regulatory authority, requesting

[1] Joint Petitioners note that the propriety of FLOW's filing in this case is questionable, as it is not a party to the proceeding, and only parties' briefs were requested by the Commission. Nevertheless, as FLOW offers essentially the same analysis as that presented by LFUCG, Joint Petitioners respond to FLOW's filing herein.

Commission approval of the transfer of control of KAWC. RWE will sell its shares of American Water, the corporate parent of KAWC, in an initial public offering ("IPO") or subsequent public offerings as may be necessary. As a result, American Water, rather than RWE, will be the ultimate parent of KAWC.

On June 19, 2006, the Commission directed the parties to file written memoranda addressing the applicability of KRS 278.020(5) and KRS 278.020(6) to this case, and stated in that same Order that it would accept responsive memoranda filed within five days after submission of the initial memoranda. The parties filed their initial memoranda on June 26, 2006. As Joint Petitioners set forth in their initial memoranda, KRS 278.020(5) and KRS 278.020(6) were not specifically drafted by the legislature with an IPO type transaction in mind. However, to the extent an IPO is subject to Commission jurisdiction, components of both subsections must be applied. Joint Petitioners and the Attorney General addressed the applicability of the statutory subsections at issue. The LFUCG, however, has made the curious additional argument that Joint Petitioners should first conduct the IPO and then seek Commission approval, and FLOW, in its Public Comment, enlarges upon this theme.

There is considerable irony in the LFUCG's and FLOW's obvious attempts to slow or halt this process, which essentially will undo the transaction to which they objected so strenuously in PSC Case No. 2002-00018.[2] Setting that irony aside for the moment, in the context of the statutory construction dispute at issue here, the LFUCG's contention that the Petition is premature – that Joint Petitioners must somehow conduct the IPO, identify all shareholders (although none will own sufficient shares to confer

[2] *Application for Approval of the Transfer of Control of Kentucky-American Water Company to RWE Aktiensgellschaft and Thames Water Aqua Holdings, GmbH.*

"control" under KRS 278.020(6)), and *then* seek Commission approval – is precisely the absurd result of a myopic reading of the statutes against which Joint Petitioners warned in their initial memorandum on this subject and demonstrates a total lack of understanding of the IPO process.

ARGUMENT

I. THE PETITION IS RIPE FOR COMMISSION REVIEW, AND THE LFUCG'S CONTENTION THAT POST-IPO APPROVAL IS REQUIRED SHOULD BE REJECTED.

The Petition before the Commission is ripe for review. The Commission will have before it all of the information and facts required for a decision. No further information regarding the nature of the transaction will be obtained by waiting until after the IPO. The Joint Petition describes at length the admittedly complex but common IPO process being proposed. In accordance with that process, all governmental approvals, including regulatory approvals, are required prior to the IPO going effective and the actual sale of stock. Given the standard operation of the stock markets and the common requirements of underwriters, it is simply not feasible to attempt to market stock if a potential governmental approval risk exists. That is particularly true where the approval statutes in question, such as Kentucky's, contain "null and void" language**.** In fact**,** if statutory review prior to the change of control is to occur at all, it must happen now, before steps are taken to effect that change in control. The LFUCG's argument to the contrary, along with that submitted by FLOW in its Public Comment, directly contradicts KRS 278.020 as well as long-settled Commission precedent, both of which unequivocally require "prior" approval of any transfer of control.

The LFUCG's tangled argument appears to be as follows: first, the LFUCG notes that KRS 278.020(5) "requires that the Commission determine whether 'the person **acquiring** the utility has the financial, technical and managerial abilities to provide reasonable service'" [Lexington-Fayette Urban County Government's Memorandum in Response to the Commission's June 19, 2006 Order ("LFUCG Memorandum"), at 3 (Emphasis in original)]. Next, the LFUCG says that "KRS 278.020(6) only applies to the acquisition of a **controlling interest** in a utility, which is presumed to occur upon the acquisition of 10% or more of the utility's voting securities" [LFUCG Memorandum at 3]. Then the LFUCG, concentrating myopically on the absence of a technical "acquirer," concludes that, because there is no "acquirer" involved, "Kentucky law does not appear to provide for Commission pre-approval under either KRS 278.020(5) or (6)" [LFUCG Memorandum at 3].[3]

Having suddenly realized that its statutory interpretation would remove the Commission from the process entirely, the LFUCG cobbles together its awkward solution: the Commission must make its decision to approve or deny the Petition *after* "the IPO process is complete and the new owner(s) of AWW have been determined" [LFUCG Memorandum at 4].

[3] In their initial memorandum filed in response to the Commission's Order of June 19, at 7, Joint Petitioners predicted that, if highly technical, word-by-word parsing of the statutes were the standard, the absence of an "acquirer" would result in defeating Commission jurisdiction under *both* subsection (5) and subsection (6). Joint Petitioners further note that the Attorney General, in his Memorandum Addressing the Application of KRS 278.020, at 4, concludes that, because there is no "acquirer," subsection (6) is not triggered. He continues to assert that the Commission has jurisdiction under subsection (5); but does not address, as the LFUCG does, the obvious problem that subsection (5) also depends upon the presence of an "acquirer."

The LFUCG's analysis, like its cobbled together solution, is hopeless. First, the LFUCG seems to have missed the requirement present in *both* KRS 278.020(5) and (6) that Commission must approve a change in control *before it takes place. See* KRS 278.020(5) ("No person shall acquire or transfer ownership of…any utility…without *prior* approval of the commission."); and KRS 278.020(6) (prohibiting a transfer of control "without having *first obtained the approval* of the commission," and providing that "[a]ny acquisition of control without *prior* authorization shall be void and of no effect.") (Emphasis added).

Next, the LFUCG ignores the practical effect of its prescription: toothpaste cannot be put back into a tube, and an IPO cannot be undone after it is complete. Should the Commission decide to deny the transaction after it has taken place, there would be no reasonable way its order could be given effect. The General Assembly clearly took these practical considerations into account when it required, in both subsection (5) and subsection (6), that the Commission approve a transfer of control *prior* to its occurrence.

Finally, the LFUCG worries that someone will, in fact, acquire controlling interest (10%) as a result of the IPO, and demands to know "how the Joint Petitioners plan to enforce this intention." The answer is simple. KRS 278.020(6) is self-effectuating, providing that acquisition of controlling interest without "prior authorization" is "void and of no effect." Joint Petitioners have already explained that potential investors will be fully informed of this provision, and must abide by the consequences. The Commission previously has held that there are no regulatory concerns under such circumstances. For example, in *In the Matter of The Public Offering of ACC Corp. as it Affects Danbury Cellular Telephone Co.*, PSC Case 91-232 (Order dated July 26, 1991), the utility assured

the Commission that a public offering of the stock of its corporate parent would not result in any one person acquiring "control." The Commission accepted these representations, adding that any person later attempting to acquire ten percent or more of the voting securities of the utility's parent corporation would be required to obtain "prior approval of the Commission or establish that such ownership will not in fact confer control, directly or indirectly, of the Kentucky utility, Danbury." *Id.* at 2.[4]

In short, the LFUCG responded to the Commission's Order of June 19, 2006 with a cramped and narrow statutory construction argument that inexorably painted itself into a legal corner in which the Commission has no jurisdiction at all. The LFUCG then attempted to extricate itself by proposing a procedure that is as impractical as it is contradictory of the literal statutory construction that the LFUCG otherwise espouses. The LFUCG's proposed procedure is also contrary to a consistent and reasonable statutory interpretation.

Either the Commission has authority to approve the Petition "prior to" the change of control, or it has no authority to approve it at all. Assuming, arguendo, that the Commission has authority, as the Joint Petition does, the law does not provide for a process whereby the Joint Petitioners to complete a change of control and then ask the Commission's blessing after the fact. Furthermore, given the notice to potential

[4] The Commission then concluded that Commission "approval of the public offering of ACC common shares is not required." *Id.* In the instant case, the KRS 278.020 analysis differs in that ultimate control will in fact pass from one corporate entity (RWE) to another (American Water). In *Danbury,* ACC Corporation retained control although its shares became publicly traded. *Danbury* provides guidance here in that it demonstrates Commission understanding that a public sale of shares, when undertaken with proper safeguards, poses no regulatory concern. Indeed, its understanding could hardly be otherwise. The PSC regulates numerous utilities whose shares, or those of their corporate parents, are publicly traded. It does not, and need not, oversee the sales of those shares to guard against acquisition of sufficient number to gain "control."

purchasers of the change of control requirements regarding acquisition of the ten percent necessary to confer "control" under the statute, there is no reason for the Commission to have any more concern than it demonstrated in *Danbury* – or that it demonstrates every day with regard to public sales of stock of entities that control other regulated utilities.

The Petition is ripe for review under both KRS 278.020(5) and (6). The LFUCG's and FLOW's contentions to the contrary should be rejected.

II. KRS 278.020 SHOULD BE CONSTRUED TO REQUIRE IMMEDIATE REVIEW PURSUANT TO BOTH SUBSECTIONS (5) AND (6).

Joint Petitioners filed this proceeding even though neither subsection (5) nor (6) literally addresses the specific proposal before the Commission: a divestiture of stock by the ultimate corporate parent (RWE) that will leave the current parent (American Water) in essentially the same relation to the utility that existed prior to the divestiture. Both LFUCG and FLOW have attempted to construe the relevant statute narrowly while still supporting Commission jurisdiction and, as a result, have produced tortured arguments that defy both logic and law.

Other curious contentions include FLOW's argument that the Commission may conclude that subsection (5) is controlling now and that it should therefore hold the case in abeyance until after the SEC process is concluded, whereupon the Commission may consider the statutory standards under both (5) and (6). It is unclear how FLOW concludes that subsection (5) can properly be triggered in the absence of an "acquirer" or how it could conclude that this subsection could, under any set of facts, be used merely as a placeholder for a subsection (6) review to take place after much of the IPO process has occurred. The analysis becomes even murkier because, at the end of the SEC process,

and even at the close of the IPO, there will be no "acquirer" of ten percent of the shares of American Water to examine.

It is equally unclear when, exactly, FLOW and the LFUCG believe the Commission should step into the process. There is no reason for the Commission to enter the legal thicket created by FLOW's and the LFUCG's "timing" argument. There is sufficient information available for the Commission to conduct its review now, and jurisdiction exists without resort to the strained statutory construction offered by LFUCG, the Attorney General,[5] and FLOW. The focus of the inquiry can and should be on American Water, which will continue to exist and whose excellent management team will continue to provide service to KAWC. Any questions the Commission may have as to the effects divestiture will have on these two entities may be asked, and will be answered, in this proceeding.

When there is as much ambiguity as exists here, the Commission must interpret statutes liberally to effectuate the General Assembly's intent to protect the interests of Kentucky customers when a change in utility control is proposed. On this point, if perhaps on no other, Joint Petitioners and FLOW agree. *See* Public Comments at 3 ("The Commission must still determine a way to comply with its statutory assessment of the proposed acquisitions under the six tests of KRS 278.020(5) and (6)"). Joint Petitioners have never disputed that the Commission should assess the proposed transaction under both KRS 278.020(5) and (6). However, that assessment should take place prior to the transaction, as the General Assembly intended and as the IPO process requires.

[5] The AG's basic argument is that only subsection (5) applies, at least for now. For all the reasons set forth in Joint Petitioners' June 26, 2006 brief, it is clear that subsections (5) and (6) apply.

CONCLUSION

Neither legislative intent nor the public interest is served by the narrow parsing of KRS 278.020 suggested by the LFUCG and FLOW, whether that parsing defeats jurisdiction, renders one subsection inapplicable, or results in the absurd conclusion that Commission approval is required *after*, or sometime *during*, rather than *prior to*, the transaction. Joint Petitioners respectfully request that the Commission hold that both subsections (5) and (6) require Commission approval in this case *prior to* any change of control; that the Petition herein is properly filed; and that this proceeding will go forward pursuant to the existing procedural schedule.

Respectfully submitted,

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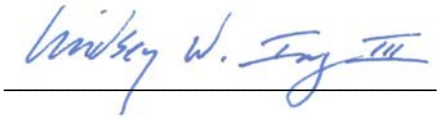
By: 

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CERTIFICATION

This is to certify that a true and accurate copy of the foregoing has been electronically transmitted to the Public Service Commission on July 3, 2006; that the Public Service Commission and other parties participating by electronic means have been notified of such electronic transmission; that, on July 3, 2006, the original and one (1) copy in paper medium will be hand-delivered to the Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; and that on July 3, 2006, one (1) copy in paper medium will be served upon the following via U.S. Mail:

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